

**STATE OF CALIFORNIA  
DEPARTMENT OF INSURANCE  
45 Fremont Street, 21st Floor  
San Francisco, California 94105**

**NOTICE OF PROPOSED ACTION**

**DATE: October 26, 2007**

**REGULATION FILE: REG-2007-00045**

**SUBJECT OF PROPOSED RULEMAKING**

The Insurance Commissioner proposes to adopt the regulations described below after considering comments from the public. The Commissioner proposes to add to Title 10, Chapter 5, Subchapter 7.5 of the California Code of Regulations the new Article 1.5: Sales to Military Personnel, consisting of new Sections 2695.20, 2695.21, 2695.22, 2695.23, 2695.24, 2695.25, 2695.26, 2695.27 and 2695.28. The regulations set forth standards to protect active duty service members of the United States Armed Forces from dishonest and predatory insurance sales practices by declaring certain identified practices to be false, misleading, deceptive or unfair.

**PUBLIC HEARING**

The Commissioner will hold a public hearing to provide all interested persons an opportunity to present statements or arguments, either orally or in writing, with respect to this regulation, as follows:

<b>Date and time:</b>	<b>Monday, December 10 at 10:00 a.m.</b>
<b>Location:</b>	<b>Department of Insurance Administrative Hearing Bureau Hearing Room 45 Fremont Street, 22nd Floor San Francisco CA 94105</b>

The hearing will continue on the date noted above until all testimony has been submitted or 4:00 p.m., whichever is earlier.

**PRESENTATION OF WRITTEN COMMENTS; CONTACT PERSONS**

All persons are invited to submit written comments on the proposed regulations during the public comment period. The public comment period will end at 5:00 p.m. on December 10, 2007. Please direct all written comments to the following contact person:

George Teekell, Staff Counsel  
California Department of Insurance  
45 Fremont Street, 21st Floor  
San Francisco, CA 94105

Telephone: (415) 538-4390

Questions regarding procedure, comments, or the substance of the proposed action should be addressed to the above contact person. In the event the contact person is unavailable, inquiries regarding the proposed action may be directed to the following backup contact person:

Joel Laucher  
California Department of Insurance  
45 Fremont Street, 22nd Floor  
San Francisco, CA 94105  
Telephone: (415) 538- 4381

## **DEADLINE FOR WRITTEN COMMENTS**

All written materials must be received by the Insurance Commissioner, addressed to the contact persons at his address listed above, no later than 5:00 p.m. on December 10, 2007. Any written materials received after that time may not be considered.

## **COMMENTS TRANSMITTED BY E-MAIL OR FACSIMILE**

The Commissioner will accept written comments transmitted by e-mail provided they are sent to the following e-mail address: teekellg@insurance.ca.gov. The Commissioner will also accept written comments transmitted by facsimile provided they are directed to the attention of George Teekell and sent to the following facsimile number: (415) 904-5490. **Comments sent to other e-mail addresses or other facsimile numbers will not be accepted. Comments sent by e-mail or facsimile are subject to the deadline set forth above for written comments.**

## **AUTHORITY AND REFERENCE**

The proposed regulations will implement, interpret and make specific the provisions of Insurance Code sections 32, 101, 330, 331, 332, 333, 334, 350, 351, 358, 359, 360, 700, 730, 733, 780, 781, 783, 783.5, 790.03, 791.02, 791.03, 1626, 10159.1, 10165, 10168, 10206.5, 10506, 10506.3, 10509.8, 10509.9 and 10540, with reference also to Military and Veterans Code section 823.5 (Stats. 2007, ch. 363, § 1 (AB 1526)). Insurance Code sections 720, 790.10, 10168.92, 10206.5, 10506 and 10506.3 provide authority for this rulemaking, as do the following decisions of the California Supreme Court: *CalFarm Ins. Co. v. Deukmejian*, 48 Cal.3d 805 (1989), and *20th Century Ins. Co. v. Garamendi*, 8 Cal. 4th 216 (1994).

## **INFORMATIVE DIGEST**

### **SUMMARY OF EXISTING LAW AND POLICY STATEMENT OVERVIEW**

Under existing law annuities are a form of life insurance. Life insurance products may be sold only by licensed life agents, appointed by and acting on behalf of an insurer. Insurers are responsible for the actions of their agents. Statements by insurers and agents about insurance, or about a person in regard to her conduct of the business of insurance,

that are known to be, or that should be known to be, untrue, deceptive or misleading are illegal. It is illegal for an agent or insurer to pretend to be, or pretend to represent, someone he or it is not or is not representing, or to misrepresent the true purpose of an interview.

According to existing law, each party to an insurance contract (the insured and the agent/insurer) when negotiating the contract has an affirmative duty in good faith to communicate to the other party all facts known to him that are, or that he believes to be, material. A fact or a representation is material if it would probably or could reasonably influence the party to whom it may be communicated in forming an estimate of the disadvantages of entering into the contract or in asking the other party questions. Unless asked, neither party has a duty to communicate: (1) any information which the other party should know, unless the communicating party has reason to suppose the other party is ignorant of that information, or (2) any information about, or that tends to prove the existence of, the existence of a risk that is not covered by the insurance, unless that information is material for some other reason.

Currently it is illegal for an agent or insurer to market a life insurance product to a service member in a misleading or deceptive manner that suggests that the insurer or agent is acting on behalf of or is an affiliate of, or that the product is being offered on behalf of, the military or the Department of Veterans Affairs. Regardless of whether the insurer or agent knows of the falsehood, (1) a materially inaccurate presentation or comparison of an existing contract when made by an insurer or agent in recommending that the contract be replaced or cashed out is illegal, and (2) a representation by an insurer or agent that is false in any material point entitles the insured to rescind the contract. A group life policy may provide that an insurer is not liable, or is liable only in a reduced amount, for losses relating to war or for losses relating to military service.

At present, the term “premium deposit fund” is undefined in California, though the term appears both in the Insurance Code and in regulations promulgated thereunder. Premium deposit funds are exempt from the provisions of nonforfeiture law, which in general specifies, among other things, minimum amounts that holders of certain annuities and other life insurance products are guaranteed to receive in the event they stop making payments.

The policy underlying the proposed action is articulated in the Military Personnel Financial Services Protection Act (the “Act”). 109 Pub. L. No. 290; 120 Stat. 1317. Section 9 of the Act states that it is the intent of Congress that “the States work collectively with the Secretary of Defense to ensure implementation of appropriate standards to protect members of the armed forces from dishonest and predatory insurance sales practices while on a military installation.” The proposed regulations seek not only to effect such standards for on-base activity but also to set out standards to protect members of the military from dishonest and predatory sales practices that take place away from military installations. Section 11 of the Act directs the National Association of Insurance Commissioners to investigate “ways of improving the quality of life insurance products sold on military installations ... which may include ... creating

standards for products specifically designed to meet the particular needs of members of the Armed Forces, regardless of sales location.” The proposed regulations seek to implement just such product standards.

## EFFECT OF PROPOSED ACTION

The proposed regulations prohibit certain acts and practices which have not previously been specifically identified as false, misleading, deceptive or unfair in rules promulgated under the Insurance Code.

Beyond requiring the disclosures mandated by Congress in Section 10 of the Act, the proposed regulations proscribe certain false, misleading, deceptive and unfair sale practices both on and off of a military installation. More than twenty prohibited practices are identified, including but not limited to: using fictitious bank accounts to establish premium payments; disparaging Service members’ Group Life Insurance (SGLI), a federally sponsored program that provides up to \$400,000 of term life insurance at a cost of \$28 per month; offering gifts or incentives to lure service members to sales presentations; soliciting in barracks and other prohibited locations; soliciting without the installation commander’s permission and implying sponsorship or sanction by the U.S. Government, the United States Armed Forces, or any state or federal or government agency.

The proposed regulations also address Congressional concerns set out in Section 11 of the Act regarding suitability and product standards. In this regard, the proposed regulations make it a deceptive or unfair trade practice to recommend to service members the purchase of any life insurance product which includes a side fund, unless the insurer has reasonable grounds for believing that the life insurance portion of the product, standing alone, is suitable. Under the proposed regulations, if a service member is enrolled in SGLI, the product is presumed unsuitable. The presumption can be overcome if the insurer, after performing a needs analysis, can show that the SGLI death benefit, together with consideration of other military survivors’ benefits and other sources of income, is insufficient for meeting the applicant’s insurable needs for life insurance.

The proposed regulations address product standards by requiring that “side” or “accumulation” funds associated with life insurance policies credit interest from the date of deposit to the date of withdrawal and to permit withdrawals without penalty; that the applicant be provided with a schedule of effective rates of return based upon cash flows of the combined product; and that no funds accumulated in the “side” or “accumulation” fund be diverted or transferred by default to pay, reduce or offset premiums.

The proposed regulations define the term “premium deposit fund” and extend the scope of that definition to apply beyond the military sales context to all uses of the term in the Insurance Code and the regulations implementing it. The definition excludes all other moneys than those set aside for the sole purpose of paying future obligations on life insurance products that have actually been issued. The proposed regulations prohibit selling or offering for sale to an active duty service member any life insurance product

which violates either the Standard Nonforfeiture Law for Life Insurance or the Standard Nonforfeiture Law for Deferred Annuities. Owing to the new definition of premium deposit fund, certain funds that previously have been exempt may now be subject to nonforfeiture protection, regardless of the military or civilian status of the people to whom the affected products are sold or marketed.

The regulations also prohibit the sale to known active duty service members of life insurance products that exclude coverage for death related to war or military service.

## **MANDATES ON LOCAL AGENCIES OR SCHOOL DISTRICTS**

The proposed regulations do not impose any mandate on local agencies or school districts. There are no costs to local agencies or school districts for which Part 7 (commencing with Section 17500) of Division 4 of the Government Code would require reimbursement.

## **COST OR SAVINGS TO STATE AGENCIES, LOCAL AGENCIES OR SCHOOL DISTRICTS OR IN FEDERAL FUNDING**

The Commissioner has determined that the proposed regulations will result in no cost or savings to any state agency, no cost to any local agency or school district that is required to be reimbursed under Part 7 (commencing with Section 17500) of Division 4 of the Government Code, no other nondiscretionary cost or savings imposed on local agencies, and no cost or savings in federal funding to the State.

## **ECONOMIC IMPACT ON BUSINESS AND THE ABILITY OF CALIFORNIA BUSINESSES TO COMPETE**

The Commissioner has made an initial determination that the adoption of the proposed regulations may have a significant, statewide adverse economic impact directly affecting business, including the ability of California businesses to compete with businesses in other states. The types of businesses that may be affected are insurers and life agents. The Commissioner has not considered proposed alternatives that would lessen any adverse economic impact on business and invites you to submit proposals. Submissions may include the following considerations:

- (i) The establishment of differing compliance or reporting requirements or timetables that take into account the resources available to businesses.
- (ii) Consolidation or simplification of compliance and reporting requirements for businesses.
- (iii) The use of performance standards rather than prescriptive standards.
- (iv) Exemption or partial exemption from the regulatory requirements for businesses.

## **POTENTIAL COST IMPACT ON PRIVATE PERSONS OR BUSINESSES**

The Commissioner is not aware of any cost impacts that a representative private person or business would necessarily incur in reasonable compliance with the proposed action. Insurers that engage in the business practices interdicted by the proposed regulations are not

representative of the insurance industry at large. However, an insurer that is representative of the group of insurers that will be affected by the proposed regulations reported direct premiums of \$14.6 million in 2006, of which approximately \$5.7 million represented first-year business for its ordinary life business. Should the proposed regulations become effective, this insurer would not be able to write its current level of military business. The immediate impact would be a loss of its first-year business that could reach \$5.7 million or more annually depending on the volume of military business that is represented in first-year premiums and the amount of new military business that the insurer could generate in future years without regulatory impediment.

The proposed regulations would force the insurer to revamp its business strategy. The company would need to develop new life products viable for sale to military and nonmilitary personnel if it planned to survive as an ongoing concern. We estimate that the development and start-up costs to launch a new life insurance product line could cost this company \$300,000 (e.g., costs of actuarial consultants, legal advice, regulatory filing and/or approvals, marketing, training, etc.) for each new product line. We also estimate that the company would incur approximately \$750,000 in system development and implementation costs to develop and implement computer applications to manage the new line of business.

To maintain the renewal of its military business that is already on its books, the company would need to revamp the way it collects premiums from military personnel. This could entail having each policyholder establish an individual checking account from a bank of the policyholder's own choosing. The insurer could then use electronic fund transfer to collect the premiums. The cost of implementing such a program would be approximately \$300,000, with a residual effect of the loss of additional business resulting from policyholders' potentially cancelling their policies instead of opting to open a new checking account. The percentage of the company's policyholders that may cancel for this reason is unknown.

## **EFFECT ON JOBS AND BUSINESSES IN CALIFORNIA**

The Commissioner is required to assess any impact the regulations may have on the creation or elimination of jobs in the State of California, the creation of new businesses, the elimination of new businesses, and the expansion of businesses currently operating in the state.

The proposed regulations could force a domestic insurer to shut down its operations, in which case the salaries, wages, and benefits lost to its employees could represent \$830,000 or more per year. Collectively the agents appointed to the company stand to lose as much as \$5.2 million in commission income. While an insurance company's agents typically are also appointed to many other insurers, several agents appointed to the company could at present derive substantially all of their commission income from sales of the company's product. The insurance businesses of some agents could therefore be eliminated, should the proposed regulations become effective, resulting in elimination of jobs held by individuals employed by those agents. Accordingly, in the Commissioner's assessment, this regulatory action will result in the elimination of businesses and jobs in California. However, the extent to which jobs and businesses will be lost will be relatively minor in terms of the State's aggregate economic activity. The proposed regulations will not, however, affect the expansion of other businesses doing business in California.

## **FINDING OF NECESSITY**

The Commissioner finds that it is necessary for the welfare of the people of the state that the regulations apply to businesses.

## **IMPACT ON HOUSING COSTS**

The proposed regulations will have no significant effect on housing costs.

## **ALTERNATIVES**

The Commissioner must determine that no reasonable alternative considered by the Commissioner or that has otherwise been identified and brought to the attention of the Commissioner would be more effective in carrying out the purpose for which this action is proposed or would be as effective and less burdensome to affected private persons than the proposed action.

## **IMPACT ON SMALL BUSINESS**

The Commissioner has determined that the proposed amendments will affect small businesses to the extent that it affects insurance agents. However, insurance companies, which will also be affected, are by definition not small businesses, pursuant to Paragraph (b)(2) of Government Code section 11342.610.

## **COMPARABLE FEDERAL LAW**

The proposed regulations refer to and require the disclosures set forth in Section 10 of the Act. The proposed regulations also track or incorporate relevant Department of Defense solicitation regulations in DoD Instruction 1344.07: *Personal Commercial Solicitation on DoD Installations*, and Army Regulation 210-7: *Commercial Solicitation on Army Installations*.

## **TEXT OF REGULATIONS AND STATEMENTS OF REASONS**

The Department has prepared an initial statement of reasons that sets forth the reasons for the proposed action. Upon request, the initial statement of reasons will be made available for inspection and copying. Requests for the initial statement of reasons or questions regarding this proceeding should be directed to the contact person listed above. Upon request, the final statement of reasons will be made available for inspection and copying once it has been prepared. Requests for the final statement of reasons should be directed to the contact person listed above.

The file for this proceeding, which includes a copy of the express terms of the proposed regulations, the statement of reasons, the information upon which the proposed action is based, and any supplemental information, including any reports, documentation and other materials related to the proposed action that is contained in the rulemaking file, is available by

appointment for inspection and copying at 45 Fremont Street, 21st Floor, San Francisco, California 94105, between the hours of 9:00 a.m. and 4:30 p.m., Monday through Friday.

### **AUTOMATIC MAILING**

A copy of this notice, including the informative digest, which contains the general substance of the proposed regulations, will automatically be sent to all persons on the Insurance Commissioner's mailing list.

### **WEBSITE POSTINGS**

Documents concerning this proceeding are available on the Department's website. To access them, go to <http://www.insurance.ca.gov>. Find at the righthand side of the page the heading 'QUICK LINKS.' The third item in this column under this heading is 'For Insurers'; on the drop-down menu for this item, select 'Legal Information.' When the 'INSURERS: LEGAL INFORMATION' screen appears, click the third item in the list of bulleted items near the top of the page: 'Proposed Regulations.' The 'INSURERS: PROPOSED REGULATIONS' screen will be displayed. Select the only available link: 'Search for Proposed Regulations.' Then, when the 'Search or Browse for Documents for Proposed Regulations' screen appears, you may choose to find the documents either by conducting a search or by browsing for them by name.

To search, enter "REG-2007-00045" (the Department's regulation file number for these regulations) in the search field. Alternatively, search using as your search term the Office of Administrative Law's notice file number assigned to the regulations ("Z-07-1016-04"), or search by keyword ("military," for example, or "side fund"). Then, click on the 'Submit' button to display links to the various filing documents.

To browse, click on the 'Browse All Regulations' button near the bottom of the screen. A list of the names of regulations for which documents are posted will appear. Find in the list the 'Sales to Military Personnel' link, and click it. Links to the documents associated with these regulations will then be displayed.

### **MODIFIED LANGUAGE**

If the regulations adopted by the Department differ from those which have originally been made available but are sufficiently related to the action proposed, they will be available to the public for at least 15 days prior to the date of adoption. Interested persons should request a copy of these regulations prior to adoption from the contact person listed above.